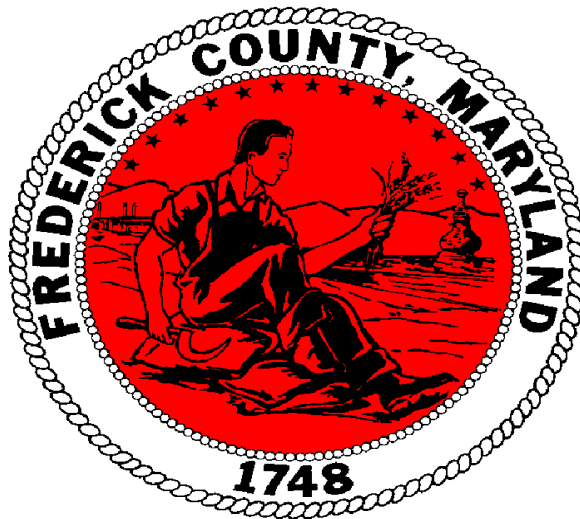


**FREDERICK COUNTY  
INTERAGENCY INTERNAL AUDIT AUTHORITY  
INTERNAL AUDIT DIVISION**

**FREDERICK COUNTY GOVERNMENT**

**OPPORTUNITIES EXIST  
TO EXPAND THE P-CARD PROGRAM  
AND IMPROVE INTERNAL CONTROLS**

**REPORT #13-02  
SEPTEMBER 19, 2012**





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# Executive Summary

In March and April 2010, Finance Division officials requested that we perform this audit to determine if the P-Card Program was operating efficiently and effectively. One of these officials requested that we determine whether the P-Card Program is expanding at the desired rate of change. Three hundred seven out of 2,811 County employees<sup>1</sup> use a P-Card, which the County encourages, but does not require, as a method of payment for low dollar goods and services. Our audit shows that the County has an opportunity to save approximately \$500,000 a year by mandating P-Cards for goods and services costing \$2,500 or less and expanding the use of P-Cards. To arrive at this savings figure, we analyzed County transactions of \$2,500 or less that were made through the procurement process, instead of using P-Cards. According to the RPMG Research Corporation *2010 Purchasing Card Benchmark Survey*, which is used by the National Association of Purchasing Card Professionals<sup>2</sup> (NAPCP), P-Cards are estimated to cost \$71 less per transaction. Details of how we estimated the cost savings are discussed in the report.

The expansion of the program must be preceded by strengthening the P-Card policies and procedures and improving controls over the P-Card Program. Our audit found certain aspects of the P-Card Program were working well. For instance, our review of selected transactions found that, with only a few minor exceptions, cardholders complied with P-Card approval and evidence requirements and purchases were made for appropriate business purposes and charged to the proper account. However, improvements are needed to make the P-Card Program more effective and efficient, and ensure compliance with established procedures. We recommend that the County:

- Establish written procedures, as suggested by the NAPCP, which describe program managers' roles and responsibilities in the P-Card Program and internal controls used to prevent and detect fraud, waste, and abuse.
- Monitor and enforce its newly established P-Card account closure procedures and internal procedures to ensure that P-Cards are deactivated upon an employee's separation from employment as we recommended in our August 2011 management memo.
- Monitor and enforce its procedures requiring cardholders to send approved P-Card statements and support to Accounts Payable for review within designated time frames, and take away P-Cards from cardholders who repeatedly do not follow the procedures.
- Periodically verify authorized approving officials and provide Accounts Payable with updated lists as changes occur.
- Provide periodic refresher training to users and approvers.

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<sup>1</sup> As of June 1, 2012

<sup>2</sup> The NAPCP is a professional association committed to advancing Commercial Card and payment professionals and industry practice worldwide.



## **P-Card Program**

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In his written response dated September 4, 2012, the County's Procurement & Contracting Manager described actions to address each recommendation with full implementation of all 14 recommendations by June 30, 2013. He stated that many of the recommendations will be implemented as the Procurement and Contracting Department transitions from Bank of America to J.P. Morgan Chase and its online card reconciliation platform, which is expected to take place this Fall, or when the Department assesses how best to achieve them in the new procurement card environment. In addition to information included in his response, he provided specific steps as to how Recommendation 7 will be implemented which involves obtaining statements and supporting documentation that had not been forwarded to Accounts Payable as required to determine if transactions were for valid business purposes, including statements of cardholders who are no longer employed by the County. We summarized his response in Section V (see page 16). The County's Procurement & Contracting Manager's entire response is an attachment to the report (see pages 19 to 23).



## P-Card Program

# I. Introduction

Internal Audit conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This report is intended to provide information to management; however, it is also a matter of public record and with the exception of any applicable disclosure exemptions, distribution should not be limited. Information extracted from this report may also serve as a method to disseminate information to the public as a reporting tool to help citizens assess government operations. Management responsible for the functional area reviews the report, and their formal written responses are incorporated into the final report per Interagency Internal Audit Authority (IIAA) policy and generally accepted government auditing standards.

It is management's responsibility to design and implement an adequate system of internal control, and it is the Internal Audit Division's responsibility to determine if management's system of internal control is functioning properly. It is also management's responsibility to decide if action should be taken in response to any reported audit recommendations, taking into consideration related costs and benefits.

# II. Background

Frederick County has established a Procurement Card (P-Card) program for authorized employees. P-Cards have been provided by the Bank of America, N.A. under an agreement with the Board of County Commissioners (BoCC) since June 25, 2001. As of June 1, 2012, 307 out of approximately 2,800 County employees<sup>3</sup> had P-Cards.

As defined by the NAPCP, "A P-Card is a type of Commercial Card that allows organizations to take advantage of the existing credit card infrastructure to make electronic payments for a variety of business expenses (e.g., goods and services). In the simplest terms, a P-Card is a charge card, similar to a consumer credit card. However, the card-using organization must pay the card issuer in full each month." With P-Cards, the end-user organization assumes liability for payment. The cardholder neither owes the card issuer nor makes payments. Each month, individual cardholder statements show total cardholder activity instead of an amount due, and the County is billed for

<sup>3</sup> According to the Human Resources Division, the County had 2,030 full-time employees and 781 part-time employees as of June 1, 2012.

## Procurement Card Program

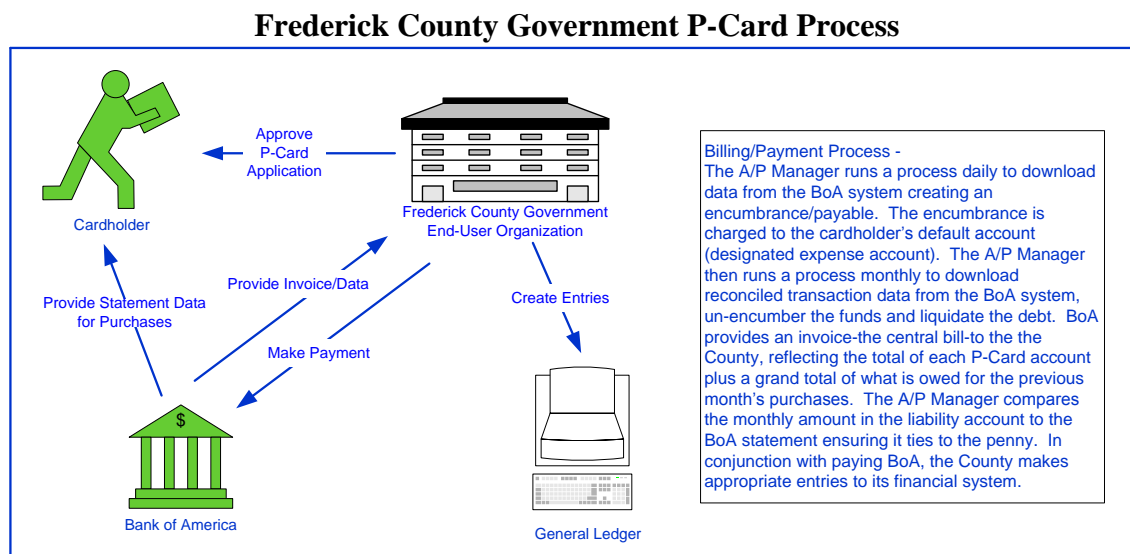
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the total purchases. County policy, however, requires end-users to sign an agreement stating that they are responsible for all improper purchases and are personally liable to reimburse the County for all incurred charges and related fees for the collection of those charges. Use of the P-Card provides benefits such as faster delivery of goods and allowed services to the end user and substantially reduces the administrative paperwork involved in buying and paying for purchases that are needed for County operations.

The P-Card Program Coordinator is the Director of Purchasing who is responsible for the overall implementation and management of the Program. The P-Card Administrator is responsible for the day to day operation and oversight of the Program. These duties include recommending policies for proper use of the card; educating cardholders on the proper use of the card, policy information, and changes to procedures; designing and delivering training programs to cardholders; resolving cardholder questions and complaints; and analyzing card usage. On April 12, 2012, an organizational change was made which renamed the Purchasing Department to the Procurement and Contracting Department and changed the Purchasing Director's title to Procurement and Contracting Director. Further, the position of Procurement and Contracting Manager was established and the P-Card Administrator now reports to the Procurement and Contracting Manager instead of the Director. In addition to the department's responsibilities for the overall implementation and management of the Program, Cardholders, Approving Officials, Card Administrators and Division Directors are required to ensure that procurement card transactions comply with the County's P-Card Policies and Procedures.

The Policies and Procedures provide the guidelines for the use of the Frederick County P-Card. For example, they state that requests for new cardholders should be submitted by the Division Director and approved by the Purchasing Director. The application includes individual and monthly transaction limits which are usually set at \$500 and \$2500 respectively. Those limits can be increased, when necessary, with the approval of both the Division and Purchasing Directors. The procedures also include examples of prohibited purchases such as items for personal use, alcohol, tobacco, firearms, ammunition, capital equipment, cash advances/checks, gasoline, gifts, services where a firm comes onto government property to perform the service, and gift cards. Cardholders are required to complete training before they receive their P-Card. After cardholders make a purchase, they are required to reconcile (verify) their transactions online and provide a hard copy of their monthly statement and receipts to their approving official for review and approval. Once completed, the statements and receipts must be forwarded to Accounts Payable who reviews the documentation for appropriate approvals and completeness.

Included on the next page is a diagram of the P-Card process, including the billing/payment process, which represents the various interactions between the issuer (Bank of America), cardholders, and the end-user organization (Frederick County Government).



On February 16, 2012, the BoCC approved transitioning the existing commercial card program from Bank of America to JP Morgan Chase, NA, based in Fairfax County, Virginia. One reason for this change is to be part of a consortium of public agency users from Maryland and Virginia that achieve rebates based on the combined usage of all members. Frederick County anticipates achieving an annual rebate between \$61,000 and \$69,000 a year based on the current volume of County P-Card expenditures. The transition to the JP Morgan Chase consortium is expected to take place in the Fall of 2012.

### III. Objectives, Scope and Methodology

In March and April 2010, Finance Division officials requested that we perform this audit to determine if the P-Card Program was operating efficiently and effectively. One of these officials requested that we determine whether the P-Card Program is expanding at the desired rate of change. The audit was approved by the IIAA as part of our FY 11 work plan.

The objectives of this audit were to determine whether internal controls are adequate to ensure that the P-Card Program is managed efficiently and effectively and whether P-Cards were used in compliance with the County's policies and procedures. The scope of this audit covered P-Card transactions from July 1, 2010 through September 30, 2011. During this period there were 30,569 transactions totaling \$6.1 million. However, tests of account closure and outstanding statements were conducted beyond September 30, 2011 to obtain the most current data to support our conclusions. While the audit included a review of the process to increase credit limits, it did not include a review of the reasonableness of those limits.

## Procurement Card Program

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To determine whether internal controls are adequate to ensure that the P-Card Program is managed efficiently and effectively, we:

- conducted a survey of cardholders and approvers and interviewed management and staff from the Finance Division's Accounting and Purchasing Departments.
- compared the County's P-Card Policies and Procedures to best practices<sup>4</sup> identified by the NAPCP.
- reviewed reports from Bank of America to identify cardholders that exceeded their credit limits without prior approval.
- tested new procedures in place to address recommendations in our Management Memo issued on August 17, 2011 to improve internal controls over the P-Card account closure procedures for terminated employees.
- performed an analysis to determine whether the use of P-Cards could be expanded and whether additional savings could be achieved.
- obtained information on the County's efforts to use another P-Card provider to benefit from rebates and incentives.

To determine whether internal controls are adequate to ensure P-Cards were used in compliance with the County's policies and procedures, we:

- selected a random sample<sup>5</sup> of 65 out of 19,013<sup>6</sup> transactions from the 14 Departments<sup>7</sup> that spent more than \$100,000 using P-Cards during the audit period (See Appendix A),
- selected a judgmental sample of 14 transactions made by the three Division Directors with the most P-Card expenditures during the audit period, and
- reviewed the 79 transactions to determine if the expenditures were properly approved, allowable, supported by receipts, purchased for a business purpose,<sup>8</sup> reasonable, charged to the proper account, and if contract prices were used, if applicable.

Further, we held discussions with selected approving officials to compare procedures they use to County P-Card policies and procedures. We used Bank of America reports to determine whether split purchases were made to avoid single purchase thresholds and Audit Command Language (ACL) reports to determine whether Maryland Sales Tax was paid contrary to the County's policies and procedures. Testing was not performed on taxes paid as they were less than \$2,000

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<sup>4</sup> *Purchasing Card Essentials, The (NAPCP's) Guide to Establishing and Managing a Program, Second Edition 2011*, which provides the fundamentals for establishing and managing a P-Card Program.

<sup>5</sup> This was a statistically valid sample based on a maximum tolerable error rate of 5 percent and a desired reliability of 95 percent.

<sup>6</sup> We excluded 775 negative transactions such as credits and refunds due to the small dollar amount involved.

<sup>7</sup> Those Departments accounted for 19,788 transactions, or approximately 65 percent of the County's 30,569 P-Card transactions and nearly \$4.3 million, or approximately 70 percent, of the \$6.1 million spent by the County using P-Cards during the audit period.

<sup>8</sup> In response to a recommendation made in our report on Frederick County Expenditures dated July 20, 2007, Procurement Card Policies and Procedures were revised to include a requirement to document the business purpose of transactions made, if not evident. A business purpose is required for meals and travel related expenses.



during the audit period and deemed immaterial. We also reviewed monthly lists from Accounts Payable to identify cardholders who did not submit P-Card statements and receipts to Accounts Payable as required.

## IV. Audit Results

Our audit found certain aspects of the P-Card Program were working well. Users and approvers responded to our survey indicating an overall satisfaction with the P-Card Program as a more efficient way of making small purchases. Our review of 79 transactions found that, with only a few minor exceptions, cardholders complied with P-Card approval and evidence requirements and purchases were made for appropriate business purposes and charged to the proper accounts. We also found that controls to prevent split purchases were adequate.

Our audit did find that the County has an opportunity to save approximately \$500,000 a year by mandating P-Cards for goods and services costing \$2,500 or less and expanding the use of P-Cards. The expansion of the program must be preceded by strengthening the P-Card policies and procedures and improving controls over the P-Card Program. To make the P-Card Program more effective and efficient, and ensure compliance with established procedures, the County should:

- strengthen its policies and procedures to describe program managers' roles and responsibilities and internal controls used to prevent and detect fraud, waste, and abuse,
- monitor and enforce account closure procedures to ensure that P-Cards are deactivated upon an employee's separation from employment,
- monitor and enforce the requirement for cardholders to send in approved statements to Accounts Payable within the designated timeframes,
- periodically verify authorized approving officials and provide Accounts Payable with updated lists as changes occur, and
- provide periodic refresher training to users and approvers.

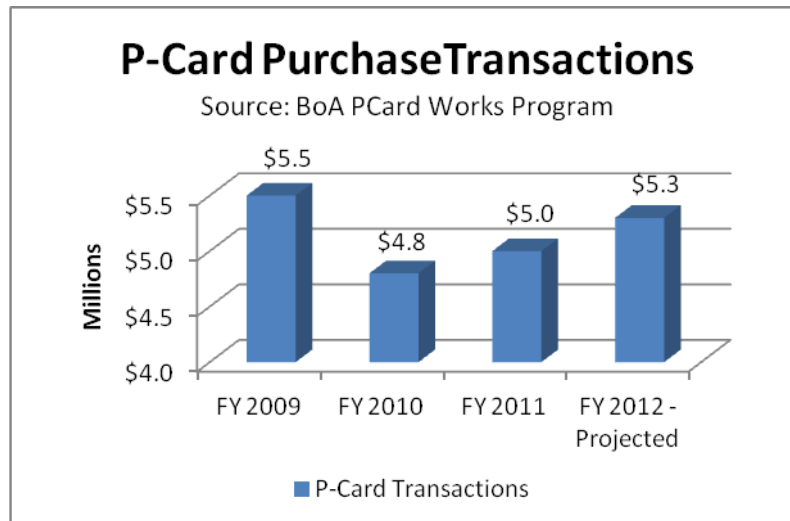
### **OPPORTUNITIES EXIST TO SAVE OVER \$500,000 ANNUALLY**

P-Cards help organizations achieve efficiencies and lower the cost of the procurement process. While the County encourages P-Cards as a method of payment for low dollar goods, opportunities exist to further increase their use and realize significant operational savings. Accordingly, the County should expand its P-Card Program to more divisions/departments and promote higher usage among the currently participating divisions/departments.

## Procurement Card Program

According to the RPMG Research Corporation 2010 Purchasing Card Benchmark Survey,<sup>9</sup> the average administrative cost (including sourcing, purchasing, and payment activities) of a traditional purchase order-based process was more than four times that of a purchasing card transaction (\$93 vs. \$22). According to the NAPCP, this is especially important in relation to small dollar transactions because the cost is the same regardless of the dollar amount of the purchase. In other words, the process cost of a \$25 purchase is the same as a \$2,500 purchase because the same process is followed. Therefore, it may cost more to purchase the item than the value of the item itself. Additionally, the RPMG survey noted that in comparison to a traditional purchase order process, purchasing cards reduce the procurement cycle time by approximately 12 days and reduce the number of suppliers managed by Accounts Payable databases by an average of 16 percent.

As shown on the following chart, the annual volume of P-Card purchases averages \$5 million annually, which represents an average of only 2% of the total County purchase dollars.



We completed an analysis covering an 18 month period indicating that the County processed nearly 23,000 P-Card eligible vouchers<sup>10</sup> that were for \$2,500 or less. Approximately 88% of the 23,000 vouchers were for less than \$1,000. We then used a conservative average of 600<sup>11</sup> transactions per month to calculate estimated savings (see the following Chart) and allow for the possibility of additional ineligible P-Card transactions. This estimate is less than one-half of the calculated average of 1,277 transactions (23,000/18 months). We discussed this methodology

<sup>9</sup> This report is a national survey with over 1,900 responses from purchasing card end users representing public and private corporations, state and federal government, city and county government, public and private universities and colleges, and school districts.

<sup>10</sup> All refunds, reimbursements, ACH payments, Sections 8 Housing vouchers, Department of Aging respite care vouchers, and JTA and Family Partnership vouchers were removed prior to calculating this total as they were not P-Card eligible.

<sup>11</sup> Based on the number of average transactions  $\leq$  \$2,500 from the population of all vouchers for the period 7/1/10 through 12/30/11 less ineligible P-Card transactions noted in Footnote 10. We cut this figure in half to be conservative and allow for the possibility of additional ineligible P-Card transactions.

## Procurement Card Program

and our calculations with the Finance Division Director who agreed with our final calculations. Further analysis indicated that many of the vouchers under \$2,500 were paid to some of the County's top P-Card vendors. Therefore, had the P-Card been used instead, the County could have saved approximately \$71<sup>12</sup> in administrative cost efficiencies per transaction.

Additional efficiencies can be achieved if the County analyzes voucher transactions using P-Cards for all vendors currently on the P-Card vendor list and if they solicit other vendors to accept P-Cards. The County should also consider steps to mandate P-Cards for lower dollar goods and services and consider options to increase P-Card usage among the divisions/departments. As the following chart indicates, if the County were to switch from the traditional payment process and use the P-Card instead for just 600 additional transactions per month they could realize savings of over \$500,000 a year.

**Frederick County Annual Savings  
Using Industry Average Process Costs<sup>12</sup>**

	TRADITIONAL PROCESS	P-CARD	DIFFERENCE
Average process cost	\$93.00	\$22.00	\$71.00
Average process cost per month (~ 600 transactions)	\$55,800	\$13,200	\$42,600 savings per month
Annualized process cost	\$669,600	\$158,400	<b>\$511,200 savings per year</b>
Number of Steps	More than 30	Fewer than 20	Omission of at least 10

The County is in the process of transitioning the existing commercial card program from Bank of America to JP Morgan Chase Bank, which features a rebate program. The program will allow the County to achieve rebates of between 1.24% and 1.4% of County P-Card expenditures. Therefore, the County can expect rebates of between \$61,000 and \$69,000 per year based on the current volume of expenditures. However, in addition to the estimated ½ million in annual savings, the County could expect to receive additional annual rebates of approximately \$34,000 to \$39,000<sup>13</sup> by expanding the P-Card Program to include just the 600 additional transactions per month.

After the County strengthens P-Card policies and procedures and improves controls over the P-Card Program, we recommend that the Procurement and Contracting Director:

**Recommendation 1:** Develop and implement strategies to promote and expand the use of P-Cards. Such strategies should include:

<sup>12</sup> Source: 2010 Purchasing Card Benchmark Survey Results by RPMG Research Corporation.

<sup>13</sup> Calculated using an average of \$384.79 per transaction.

- a. Requiring P-Card use for all purchases under a set dollar threshold such as \$2,500 for any vendor who accepts the County P-Card, and immediately requiring the use of P-Cards for qualified purchases from those vendors already on the current P-Card vendor list.
- b. Analyzing divisional/departmental purchasing patterns.
- c. Soliciting other vendors to accept County P-Cards.
- d. Setting performance goals for the County based on the number of participating divisions/departments and yearly P-Card purchase volume.

### **POLICIES AND PROCEDURES SHOULD BE STRENGTHENED**

County management has opportunities to improve the operational effectiveness of the P-Card Program by strengthening its policies and procedures as it transitions to the JP Morgan Chase system. Improved procedures are needed to ensure that program managers have written instructions as to their roles and responsibilities in the P-Card Program and to describe internal control procedures that protect the County against fraud, waste, and abuse. Guidance suggested by the NAPCP and contained in Appendix B should be used as a benchmark to ensure that any gaps in internal controls are identified and corrected.

The NAPCP recommends developing an administration manual, in addition to P-Card policies and procedures for users, to define specific management operations and procedures and promote consistency among staff and back-up staff members, and provide guidance in the event of personnel changes. The manual is needed to specify how program management carries out its job duties associated with, among other things, opening accounts and issuing cards, P-Card training, tracking the status of fraud and disputes, policy violations by cardholders or others, and communicating with management. The manual should include guidance on program reporting. The NAPCP includes examples of common reports that can be used to identify such things as declined transactions, access to P-Card technology and roles, new and inactive accounts, and unusual activity and disputes. These reports can be used to reveal potential misuse or fraud by employees and merchants. Most importantly, an administration manual is needed to document procedures for managing an effective control environment, which includes establishing preventive and detective controls to minimize risk.

In addition to NAPCP's guidance on establishing an effective control environment, an article in the November/December 2011 issue of the Association of Certified Fraud Examiners'<sup>14</sup> (ACFE) *Fraud Magazine* recommended preventive and detective controls that should be in place for any P-Card Program. The article discussed red flags, or common themes, identified in investigations that are an indication that a person's actions should be monitored more diligently. For example, background checks are recommended for all cardholders as a preventive control. While the

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<sup>14</sup> The ACFE is the world's largest anti-fraud organization whose mission is to reduce the incidence of fraud and white-collar crime and to assist the membership in fraud detection and deterrence.

County's P-Cards users do not have access to cash, in our opinion, performing credit checks before issuing P-Cards could be put in place as an alternative control. Implementing a three-strike rule to cancel P-Cards for repeated abuses is an example of a detective control. Purchases made after business hours from restaurants, gas stations, and other merchants are a red flag. We have provided a chart showing suggested preventive and detective controls and red flags in Appendix B.

In addition to issuing a P-Card administration manual, the NAPCP also suggests that certain items be included in the P-Card Policies and Procedures Manual. These items include a list of individuals who provide program management support and a brief description of their roles in the program, a requirement for the program administrator to document management approval of requests to make temporary or permanent changes to P-Card accounts, an overview of the process to alert cardholders that transactions are being monitored, instructions to specify that managers reviewing P-Card purchases shall pay special attention to any potential card misuse, and a mechanism by which violations can be tracked and reviewed.

We recommend that the Procurement and Contracting Director:

**Recommendation 2:** Develop an administration manual for program management staff that:

- a. defines program management staff's specific operations and procedures; promotes consistency among program management and back-up staff members; and provides guidance in the event of personnel changes, and
- b. establishes preventive and detective controls over the P-Card Program and identifies "red flags" which indicate the need for increased monitoring to identify if fraud has occurred. Guidance suggested by the NAPCP and contained in Appendix B should be used as a benchmark to ensure that any gaps in internal controls are identified and corrected.

**Recommendation 3:** Incorporate best practices suggested by the NAPCP in the P-Card Policies and Procedures Manual as stated above.

### **P-CARDS SHOULD BE DEACTIVATED PROMPTLY UPON SEPARATION OF EMPLOYMENT**

The County established P-Card account closure procedures and internal procedures to ensure that P-Cards are deactivated upon separation of employment as we recommended in our August 17, 2011 management memo to the Acting County Manager and Assistant County Manager. We found that as of February 2012, the procedures were not always being followed and two employees' P-Cards were not deactivated upon separation of employment to reduce the risk to the County of further use.

- In October 2011, the Purchasing Department issued detailed internal procedures for closing P-Card accounts, which included the requirement for Division Directors to notify the P-Card Administrator in a timely manner when a P-Card account in their Division is to be closed. The procedures also included a requirement for the P-Card Administrator to suspend<sup>15</sup> the P-Cards in the issuing bank's online system no later than the effective date in the notification, close the accounts, and destroy P-Cards received from Division Directors. The P-Card Administrator is also required to track activities in the P-Card closure process and a designated employee not involved with the day-to-day management of P-Cards is to verify, on a quarterly basis, that closures have been conducted in accordance with the procedures.
- In November 2011, the Purchasing Department issued an internal procedure for the P-Card Administrator to report to each Division Director, three times a year, the names of cardholders in their Division for verification and approval.
- On December 7, 2011, the Purchasing Director issued Memo #12-093 changing the P-Card Policies and Procedures to include account closure procedures as recommended in our Management Memo. To ensure that P-Cards of employees who separate from employment or change status are returned to Purchasing, the procedures required Payroll staff to forward to the P-Card Administrator a copy of each County Property Checklist for Employee Termination-Checklist #1 form, no less than bi-weekly, indicating possession of a P-Card.

We believe the internal procedures and revised P-Card Policies and Procedures for P-Card account closure strengthened the internal controls. However, our audit test of all employee separations between June 28, 2011 and February 10, 2012 found that the procedures were not always being followed. This occurred primarily because some Division Directors did not notify the P-Card Administrator or Purchasing Office Manager that their employees had separated from employment or changed status<sup>16</sup> even though there was a new requirement to do so.

As shown on the following chart, Division Directors did not notify the P-Card Administrator or Office Manager for four of seven employees who separated from employment or changed status after December 7, 2011 and P-Cards were not suspended promptly for two of the employees. Neither employee used their P-Cards after their employment ended and before the cards were suspended.

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<sup>15</sup> Suspension prevents any additional purchases from being made, but allows delayed posting of authorized transactions, refunds, disputes and other account reconciliation activity to continue.

<sup>16</sup> One employee is on Workers Compensation.

Employee	Date of Separation or Change in Status	Notification of Separation/Change Not Received from Division Director	Date Card Suspended by P-Card Administrator	P-Card Not Turned in to P-Card Administrator
1	12/16/11 <sup>17</sup>	✓	1/02/12	
2	12/23/11	✓	1/02/12	✓
3	01/01/12		1/02/12	
4	01/01/12		1/02/12	
5	01/01/12		1/02/12	
6	01/01/12	✓	1/02/12	
7	02/01/12	✓	2/02/12	✓

Upon review in February 2012, we also found that the P-Card Administrator had not been receiving the County Property Checklist for Employee Termination-Checklist #1 from Payroll as required by the revised P-Card policies and procedures. The checklists are required to be provided to the P-Card Administrator to ensure that P-Cards of employees who separate from employment or change status are returned to the Purchasing Department. This has been corrected.

In February 2012, we reviewed the P-Card Account Closure and Activity Spreadsheet established to track events in the closure process tracking system as required by the Purchasing Department's internal procedure dated October 25, 2011 and found that the spreadsheet was not kept up to date as required.

To ensure that P-Cards are deactivated timely, we recommend that:

**Recommendation 4:** The Procurement and Contracting Manager inform the Finance Division Director and County Manager in writing when Division Directors do not follow procedures for the timely cancellation and return of P-Cards.

**Recommendation 5:** The P-Card Administrator maintain a current P-Card Account Closure and Activity Spreadsheet to track events in the closure process as required by the Purchasing Department's internal procedures.

**Recommendation 6:** The Procurement and Contracting Director ensure that the P-Card Account Closure and Activity Spreadsheet is independently verified quarterly as required by the internal procedures.

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<sup>17</sup> Employee went on Workers' Compensation.

### **CARDHOLDERS MUST SEND STATEMENTS TO ACCOUNTS PAYABLE PROMPTLY**

The County has not enforced its procedures or taken P-Cards away from cardholders who repeatedly did not comply with requirements to send approved P-Card statements and support to Accounts Payable for review within designated time frames. Not only have statements been sent in as late as 20 months, but our audit indicated that many statements have not been sent in at all. As a result, the County has no assurance that the transactions on the missing statements were reviewed and approved or that they were for valid business purposes even though Bank of America had already been paid.

As of December 31, 2011, a manual report provided by Accounts Payable<sup>18</sup> identified 57 cardholders, about 17% of the total cardholders, who had not submitted 140 statements for review. Eleven of the cardholders were missing between 5 and 7 statements each for a total of 66 statements among them (see the following Chart for details). Nine of the 140 missing statements date back to July 2009, and 16 of the 57 cardholders are no longer employed by the County.

ANALYSIS OF MISSING P-CARD STATEMENTS  
AS OF DECEMBER 31, 2011

# of Cardholders	# of Missing Statements	Total Missing Statements
4	7	28
3	6	18
4	5	20
3	4	12
4	3	12
11	2	22
28	1	28
<b>57</b>		<b>140</b>

The report also identified 36 cardholders who turned in 66 statements and supporting documentation more than 6 months after they were due. Some were submitted between 13 and 20 months late. The report indicated that one cardholder submitted 15 late statements and another had submitted 12 late statements and was missing 7 statements; however, their P-Card use was not limited in any way.

P-Card policies and procedures require cardholders to submit original bank statements, receipts, and any other supporting documentation with an approving official's signature to Accounts Payable for review. The policies and procedures also state that "If for any reason the cardholder is unable to review the statement within the **designated time frame** (bold added for emphasis), a

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<sup>18</sup> Accounts Payable manually identified 129 individual cardholders who did not comply with requirements to send in approved P-Card statements and support within the designated time frames (57 with missing statements and 109 with late statements. The total does not foot to 129 because cardholders had both missing and late statements.



Backup Reconciler or an Approving Official is responsible for reviewing and certifying the cardholder's statement. It is of extreme importance that the Procurement Card Reconciliation be completed within the designated time frame. On the 25<sup>th</sup> of each month, procurement card transactions are posted to the general ledger. If the reconciliation has not been completed, the transactions are posted to the cardholder's default account." Although the policies and procedures suggest that the designated time frame is the 25<sup>th</sup> of the month because that is the date that transactions are posted, they do not clearly state when documents are due so that users know when they will be considered late.

There are no policies or procedures requiring the P-Card Administrator to follow-up with cardholders when they do not turn in statements and support and limited follow-up resulted in cardholders continuing the pattern of noncompliance. We brought this to the attention of the Finance Division Director and as a result, Accounts Payable began making the monthly missing/late statement report available to the P-Card Administrator online in April 2012. The report prepared by Accounts Payable to track the missing/late statements is prepared manually and does not track or identify the dollar amount of the charges related to missing statements. We were informed this information could, however, be accumulated manually, if necessary. Consequently, the County does not have assurance that these P-Card expenses were ever approved or that they represent valid business purchases. Since many of the missing statements are very old and some of the cardholders are no longer employed by the County, supporting documents may no longer be available for review. Therefore, the County's ability to identify any fraud, waste or abuse and recover any inappropriately spent funds may be limited.

We recommend that the Procurement and Contracting Director:

**Recommendation 7:** Require the P-Card Administrator and appropriate manager to obtain all statements and available supporting receipts/documents currently missing, including the statements of cardholders who are no longer employed by the County, and determine if the transactions were for valid business purposes.

**Recommendation 8:** Implement a procedure to place cardholders' P-Cards on hold status if they do not reconcile and submit their documents by the due date or if there are missing receipts. Additionally, cardholders' privileges should be cancelled if they repeatedly abuse the policies/procedures (i.e., implement a three-strike rule).

**Recommendation 9:** Update the P-Card policies and procedures to include:

- a. a clear deadline for submitting approved statements and support to Accounts Payable,
- b. the practice of having Accounts Payable make the monthly missing/late statement report available to the P-Card Administrator online, and
- c. a requirement that the P-Card Administrator follow-up with cardholders immediately to obtain any missing and late statements.

**Recommendation 10:** When the new P-Card system is implemented, include processes to:

- a. ensure transactions contain support and are approved, and
- b. generate missing statement/receipt reports showing total charges by cardholder.

### **PERIODIC VERIFICATION OF P-CARD APPROVERS IS NEEDED**

During our interviews with IIT staff and approving officials, we found that the P-Card approval process was set up using the same approval path as the PeopleSoft voucher approval path. This unintentionally provided some approving officials with the ability to approve their own transactions and those of their peers. Although there is a risk some approvers could inappropriately approve transactions, our testing did not reveal any instances where this occurred. The Procurement & Contracting Manager stated in an email that, under the new P-Card system, approving officials will not have the ability to approve their own card transactions.

We also identified the following related internal control issues:

- There are approving officials that are no longer employed by the County that are still in the system. (The Procurement & Contracting Manager stated that these people will be removed when the new P-Card system is put in place.)
- Unauthorized approving officials are included in the system. (The Procurement & Contracting Manager stated that, under the new P-Card system, only appropriate approving officials will be included based upon Division Head requests.)
- The P-Card Administrator has the ability to approve any P-Card in the system and is the regular approving official on 5 cardholders' transactions/monthly statements.
- Approving officials are not always aware that there are transactions awaiting their approval because they do not receive any sort of notification.
- Accounts Payable does not have a list of approving officials and related cardholders to use when verifying that statements have been properly approved by the appropriate approving official.

According to the Frederick County Procurement Program Policies & Procedures, Section II, "Under most circumstances, a cardholder cannot be his/her own approving official." Further, as stated by the NAPCP, separation of duties is a key control and should be required, and there must be an "Independent review of a cardholder's transactions, such as by the cardholder's manager, to detect potential fraud and misuse."

Accordingly, we are recommending that the Procurement and Contracting Director:

**Recommendation 11:** Periodically verify authorized approving officials and provide Accounts Payable with an updated list as changes occur so that they can ensure that employees approving the statements are authorized.

**Recommendation 12:** Remove the P-Card Administrator as an approving official for all P-Cards.

**Recommendation 13:** Ensure that approving officials are notified that they have transactions to approve.

### **P-CARD USERS AND APPROVERS WOULD LIKE ADDITIONAL TRAINING**

In July 2011, we sent a survey to 349 County employees that were P-Card users and/or approvers and we received responses from 197, or 56 percent, indicating an overall satisfaction with the P-Card Program. On November 21, 2011, we provided the survey results to the Finance Division Director. Many employees stated that using P-Cards was a more efficient way of making small purchases than using purchase orders. However, some employees wanted periodic P-Card refresher training and e-mail notifications indicating that they have transactions to review and approve. Further, some employees were unaware of prohibited items or vendors and unaware of when purchases should be made under contract. Also, some employees said they did not know what is required when employees change divisions or employment status. Details are shown on the following chart.

**Analysis of Selected Survey Responses<sup>19</sup>**

<b>Responses<sup>20</sup></b>	<b>P-Card Users</b>	<b>P-Card Approving Officials</b>	<b>P-Card Users Who Are Also Approving Officials</b>
Want Periodic Refresher Training	19%	20%	21%
Unaware of prohibited items or vendors	10%	30%	11%
Want e-mail notification to review transactions <b>See Recommendation #13</b>		70%	72%
Unaware of when purchases should be made under contract	12%		
Does not know what is required when employee changes division or employment status	13%	40%	19%

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<sup>19</sup> While 197 employees responded, not all employees responded to every question.

<sup>20</sup> Includes responses of Strongly Agree and Agree.

To address concerns expressed in our survey, we recommend that the Procurement and Contracting Director:

**Recommendation 14:** Provide periodic refresher training to users and approvers and include a review of prohibited items and vendors, use of existing contracts to ensure that the agreed upon prices are obtained, and the process when employees change division or employment status.

## V. Summary of Response

The County's Procurement & Contracting Manager agreed to implement all 14 recommendations by June 30, 2013. Actions to be taken include formalizing strategies for program growth, developing an administrative manual to more systematically manage the program, strengthening its P-Card account closure procedures, implementing a system of progressive discipline for non-compliance with P-Card policies and procedures or repeated abuse, and making refresher training for cardholders, reconcilers, and approving officials available on a monthly basis. Alternative action was suggested to implement Recommendation No. 9 since functions currently performed by Accounts Payable will be transferred to the P-Card Administrator who will follow-up with the cardholder and the cardholder's approving official, and with the Division Director for repeated lapses in submitting statements (see Attachment).

In addition, on September 12, 2012, at our request, the Procurement & Contracting Manager provided specific steps as to how Recommendation 7 will be implemented. He stated that they will validate the list of cardholders who did not provide statements and documentation to Accounts Payable as required, work with appropriate managers and Bank of America to collect available documentation, determine if transactions were for valid business purposes, and compile a list of questionable transactions for appropriate follow-up.

*Interagency Internal Audit Authority*

September 19, 2012

Interagency Internal Audit Authority

### Audit Team

Richard Kaplan, Internal Audit Director  
Kelly Hammond, Senior Auditor II  
Diane Bowers, Auditor II  
Heather Frumkin, Auditor II  
Jason Myers, Auditor II

**Departments with  
P-Card Expenditures Over \$100,000  
During the Period 7/1/10 – 9/30/11**

	<b>Total Number of P-Card Transactions</b>	<b>Total Amount of P-Card Transactions</b>	<b>Number of P-Card Transactions Tested</b>
Fleet Services	7,588	\$1,733,972	19
Parks and Recreation	3,286	442,244	8
Maintenance	2,239	364,752	8
General Fund-Cap Projects	839	256,390	3
Logistics Support-Fire	376	185,477	2
Highway Operations	1,065	184,228	5
Fire and Rescue	967	182,313	3
Sheriff/Law Enforcement	698	168,008	2
Plant Ops (DUSWM)	688	144,195	2
Urban Advance Life Support	199	126,965	2
Library Operations	721	126,254	3
Detention Center	459	125,011	2
Urban Fire Tax Districts	271	116,286	4
Facility Services	392	105,680	2
<b>Total of 14 Departments Reviewed</b>	<b>19,788</b>	<b>\$4,261,775</b>	<b>65</b>
<b>Total Countywide (157 Departments)</b>	<b>30,569</b>	<b>\$6,127,527</b>	
<b>Percentage of Population Included in Audit</b>	<b>65%</b>	<b>70%</b>	

Preventive and Detective Controls and Red Flags<sup>21</sup>

Preventive Controls	Detective Controls (Retrospective actions to identify questionable transactions)	Red Flags
Background checks for cardholders (In our opinion, although background checks may not be appropriate for all cardholders, credit checks are a critical control and should be put in place before issuing a P-Card.)	Perform reviews of transactions, explanations, and receipts in a timely manner. Place P-Cards on hold status if reconciliations are not completed by the due dates or there are missing receipts.	The individual has been placed on probation for performance issues and the individual may expect to be terminated and feel that he or she has nothing to lose by misusing the P-Card.
P-Cards should have reasonable monetary single and monthly limits. (Single transaction and monthly transactions are used, but there are no formal procedures to periodically review the adequacy of the limits).	Implement a three-strike rule to cancel P-Cards for repeated abuses.	Monthly reconciliations were always late or not performed. The employee presented several reconciliations at a time or stated that the reconciliations needed to be signed quickly due to a deadline, which reduces the amount of time for review. This allows unauthorized transactions to be hidden.
Merchant Classification Codes (MCC) should be used to prohibit P-Card use with suppliers in different industries.	Generate monthly reports on spending trends, potential split transactions, and dollars by merchant which should be forwarded to the appropriate manager.	The employee submitted receipts with a long list of purchase items. Personal items can be hidden with lengthy lists.
Place P-Cards on hold if employees are on probation. This is also a good control when employees are on extended leave.	Provide an anonymous tip line.	Purchases were made after business hours from restaurants, gas stations, and other merchants and the person can say the P-Card was used by mistake.
Educate cardholders, administrators, and supervisors on card-related roles and responsibilities on an annual basis. (The County currently provides training upon issuance of a P-Card, but does not provide refresher training. Also, training is not provided to approving officials who do not use a P-Card).	Strong policy that states clearly what the P-Card can and cannot be used for and identify the disciplinary action for accidental misuse versus intentional misuse.	Supervisors were not taking the time to examine the monthly reconciliations.

<sup>21</sup> Preventing, Detecting, and Investigating Procurement Card Abuse from the November/December 2011 issue of the ACFE *Fraud Magazine*



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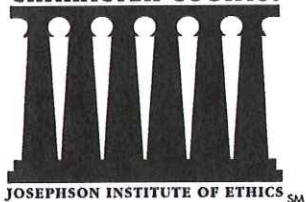
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# FINANCE DIVISION FREDERICK COUNTY, MARYLAND

## *Procurement and Contracting Department*

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DATE: September 4, 2012

TO: Richard Kaplan, Director  
Internal Audit Division

FROM: Bruce Johnson, Procurement & Contracting Manager 

RE: Changes in Procurement Card Policies and Procedures

MEMO: #13-035

**BACKGROUND:** As an outcome of an audit performed by the Internal Audit Division the recommendations identified below were made to strengthen and improve the operations of the County procurement card program.

The Procurement and Contracting Department ("the Department" herein) offers the following responses to the recommendations provided. The Department is currently working to transition the issuing bank of the County's procurement cards from the Bank of America to J.P. Morgan Chase. Training is scheduled for mid September for new cardholders, reconcilers and approving officials. Many of the recommendations made by the Internal Audit Division will be implemented either as we transition to the new issuing bank and its online card reconciliation platform or as we have an opportunity to assess how best to achieve them in the new procurement card environment.

### **RECOMMENDATIONS AND RESPONSES:**

**Recommendation 1:** *Develop and implement strategies to promote and expand the use of P-Cards. Such strategies should include:*

- a. *Requiring P-Card use for all purchases under a set dollar threshold such as \$2,500 for any vendor who accepts the County P-Card, and immediately requiring the use of P-Cards for qualified purchases from those vendors already on the current P-Card vendor list.*
- b. *Analyzing divisional/departmental purchasing patterns.*
- c. *Soliciting other vendors to accept County P-Cards.*
- d. *Setting performance goals for the County based on the number of participating divisions/ departments and yearly P-Card purchase volume.*

**Response:** The Department concurs that the County would benefit from the implementation of strategies to promote and expand the use of P-Cards. The Department would like to complete the transition and stabilize the procurement card program to ensure a solid program foundation before it develops strategies to promote and expand the use of p-cards. The Department will work with JP Morgan Chase and other County stakeholders to identify strategies for

program growth and expects to formalize these strategies by the close of this fiscal year (June 2013).

**Recommendation 2:** *Develop an administration manual for program management staff that:*

- a. *defines program management staff's specific operations and procedures; promotes consistency among program management and back-up staff members; and provides guidance in the event of personnel changes, and*
- b. *establishes preventive and detective controls over the P-Card Program and identifies "red flags" which indicate the need for increased monitoring to identify if fraud has occurred. Guidance suggested by the NAPCP and contained in Appendix B should be used as a benchmark to ensure that any gaps in internal controls are identified and corrected.*

**Response:** The Department concurs that the development of an administrative manual is warranted to create a more systematic approach to management of the program. Staff is currently working to develop such a manual based on NAPCP guidance and functionality resident in PaymentNet, J.P. Morgan Chase's online program management platform. While a draft currently exists of the administrative manual, the Department would like to operate the new program for a period of time before finalizing the administrative manual. The goal for completion of a final version of the administrative manual is March of 2013.

**Recommendation 3:** *Incorporate best practices suggested by the NAPCP in the P-Card Policies and Procedures Manual as stated above.*

**Response:** As noted above, the Department is using such practices in the development of its administrative manual and the policies and procedures.

**Recommendation 4:** *The Procurement and Contracting Manager inform the Finance Division Director and County Manager in writing when Division Directors do not follow procedures for the timely cancellation and return of P-Cards.*

**Response:** The Department currently has a (desktop) procedure in place to periodically verify the timeliness of p-card account closure. A quarterly review of account closure activity is performed however the procedure does not currently specify that written notification be delivered to either the Director of Finance or the County Manager. The responsibilities of various staff members in the Department are currently undergoing change. A new designee for performing the periodic review will be identified and the requirement to provide written notification by the Procurement & Contracting Manager to the Director of Finance and the County Manager will be added. This desktop procedure will either be adopted into the new administrative manual or will be referenced as an attachment thereto. If the action taken is to revise the desktop procedure, this would be completed no later than the end of November 2012, if done within the administrative manual it would be finalized in March 2013.

**Recommendation 5:** *The P-Card Administrator maintain a current P-Card Account Closure and Activity Spreadsheet to track events in the closure process as required by the Purchasing Department's internal procedures.*

**Response:** The Department adopted a desktop procedure requiring the procurement card administrator to track events in the closure process. This desktop procedure will either be adopted into the new administrative manual or will be referenced as an attachment thereto.



**Recommendation 6:** *The Procurement and Contracting Director ensure that the P-Card Account Closure and Activity Spreadsheet is independently verified quarterly as required by the internal procedures.*

**Response:** The Department adopted a desktop procedure requiring that the Account Closure Spreadsheet be verified quarterly. This desktop procedure will either be adopted into the new administrative manual or will be referenced as an attachment thereto.

**Recommendation 7:** *Require the P-Card Administrator and appropriate manager to obtain all statements and available supporting receipts/documents currently missing, including the statements of cardholders who are no longer employed by the County, and determine if the transactions were for valid business purposes.*

**Response:** Currently Accounts Payable staff identifies missing statements to the P-Card Administrator for follow up. The P-Card Administrator then attempts to collect missing statement and supporting receipts/documents. As the program transitions to the new issuing bank, the P-Card Administrator will become responsible for identifying missing statements and follow-up. Implementation of new policies should dramatically reduce the numbers of missing statements (the "three-strike" rules, see response to Recommendation 8 below). The P-Card Administrator will continue to follow up on existing missing statements with assistance as necessary from the Procurement & Contracting Manager.

**Recommendation 8:** *Implement a procedure to place cardholders' P-Cards on hold status if they do not reconcile and submit their documents by the due date or if there are missing receipts. Additionally, cardholders' privileges should be cancelled if they repeatedly abuse the policies/procedures (i.e., implement a three-strike rule).*

**Response:** The Department concurs that a system of progressive discipline should be included to address such circumstances. The procedures shall be identified in the cardholder policies and procedures and in the administrative manual.

**Recommendation 9:** *Update the P-Card policies and procedures to include:*

- a. *a clear deadline for submitting approved statements and support to Accounts Payable,*
- b. *the practice of having Accounts Payable make the monthly missing/late statement report available to the P-Card Administrator online, and*
- c. *a requirement that the P-Card Administrator follow-up with cardholders immediately to obtain any missing and late statements.*

**Response:** The Department concurs with these recommendations but suggest alternate action to achieve the desired results. The deadlines for submitting statements will be incorporated into training and the cardholder policies and procedures. Functions currently performed by Accounts Payable will be transferred to the P-Card Administrator under the new program however and the monthly missing late statement will be generated in the Department rather in Accounts Payable. The P-Card Administrator will perform follow-up with the cardholder, the cardholder's approving official and, for repeated lapses, with the cardholder's Division Director. These procedures shall be incorporated as either desktop procedures or directly into the administrative manual. If the action taken is to create a desktop procedure, this would be completed no later than the end of November 2012. If it determined best to write it the procedures into the administrative manual, such addition would be finalized with the administrative manual in March 2013.

**Recommendation 10:** *When the new P-Card system is implemented, include processes to:*

- a. *ensure transactions contain support and are approved, and*
- b. *generate missing statement/receipt reports showing total charges by cardholder.*

**Response:** The Department concurs with this recommendation. The p-card policies and procedures require that transaction support be maintained and transaction be approved in a timely manner. The parameters of timeliness will change with the implementation of the new JP Morgan Chase card program as the reconciliation process changes to twice monthly (statements are only provided once a month by JP Morgan Chase so the requirement to submit statements and transaction backup will remain at once per month). As indicated in the response to Recommendation 9, missing statement/receipts will be identified by Department staff. Staff will investigate the means to produce a report from PaymentNet showing total charges by cardholder (for those cardholders with missing statements/receipts). The procedures developed will be incorporated into the administrative manual to be finalized in March 2013.

**Recommendation 11:** *Periodically verify authorized approving officials and provide Accounts Payable with an updated list as changes occur so that they can ensure that employees approving the statements are authorized.*

**Response:** The Department adopted a policy to periodically report the name of p-card holders to division directors. This policy will be revised to include approving officials in the report as well. This desktop procedure will either be adopted into the new administrative manual or will be referenced as an attachment thereto. Revisions to the desktop procedure shall be completed no later than December 2012 and will be adopted as text or an attachment into the administrative manual when it is finalized (March 2013).

**Recommendation 12:** *Remove the P-Card Administrator as an approving official for all P-Cards.*

**Response:** The Department concurs. The Procurement Card Administrator will not have an approving role in the PaymentNet system that will be utilized to manage the new p-card program.

**Recommendation 13:** *Ensure that approving officials are notified that they have transactions to approve.*

**Response:** The PaymentNet system includes functionality to notify approving officials that they have transactions to approve. The system does allow users (approving officials, in this case) to turn off the notification. The training to be provided to new users and approving officials will encourage them to leave this feature active but the ability to turn off the notification cannot be overridden by the Department. The use of this functionality will commence with use of the new system.

**Recommendation 14:** *Provide periodic refresher training to users and approvers and include a review of prohibited items and vendors, use of existing contracts to ensure that the agreed upon prices are obtained, and the process when employees change division or employment status.*

**Response:** The Department concurs with this recommendation and will:

- a. make available refresher training for cardholders, reconcilers and approving officials on a monthly basis (commencing after implementation of the new JP Morgan Chase card program)..
- b. in concert with developing strategies to expand the use of p-cards (see Recommendation 1) work with stakeholders to develop strategies to ensure the use of existing contracts and that the correct price has been charged;

- c. identify the procedures necessary when a cardholder changes division or employment status (to be documented in both the policies and procedures and by a desktop procedure or within the administrative manual no later than December 2012.